

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:RFP:ATL:TL-N-124655-02
CLRountree

date: June 21, 2002

to: Mr. Timothy Bowles
Manager, LMSB Group [REDACTED] (HMT)
Internal Revenue Service
2303 W. Meadowview Road
Suite 100C
Greensboro, North Carolina 27407

from: Associate Area Counsel, Atlanta
(Retailers, Food and Pharmaceuticals)

subject: [REDACTED], LLC

E.I.N.: [REDACTED]

Address: [REDACTED]

Forms 1065 for Taxable Years Ended December 31, [REDACTED]
through December 31, [REDACTED], inclusive

Related Taxpayer-Members:

(1)

S.S.N.: [REDACTED]

Address: [REDACTED]

Taxable Year Ended December 31, [REDACTED]

Earliest Statute of Limitations: [REDACTED]

(2)

also known as tax matters matter of [REDACTED], LLC

S.S.N.: [REDACTED]

Address: [REDACTED]

Taxable Year Ended December 31, [REDACTED]

Earliest Statute of Limitations: Unknown

(3) [REDACTED]
S.S.N.: [REDACTED]
Address: [REDACTED]
Taxable Year Ended December 31, [REDACTED]
Earliest Statute of Limitations: Unknown

This memorandum responds to your written request for assistance dated [REDACTED] related to the taxable year for which [REDACTED], LLC ([REDACTED]) is entitled to a charitable deduction under I.R.C. §170 with respect to real property located in [REDACTED], Ohio and subject to a lease with [REDACTED], Inc. ([REDACTED]). In addition to the issues raised in your request, we have addressed other issues that surfaced during our review of the file and applicable law.

Based on the following discussion, we have concluded that [REDACTED] is not entitled to any deduction under I.R.C. §170 for any interest in the property before the taxable year ended December 31, [REDACTED]. However, subject to [REDACTED]'s satisfaction of the substantiation requirements imposed by I.R.C. §170(f)(8) and applicable regulations for the taxable year ended December 31, [REDACTED], the amount of any allowable deduction will be limited to the value on the date of the [REDACTED]'s delivery to and acceptance by [REDACTED] of the deed ([REDACTED]) of [REDACTED]'s reversionary interest in the land and building and improvements on the property as of the commencement of the lease in [REDACTED].

In light of our conclusion, we recommend that you take the actions set forth below on pages 40 through 44, inclusive, of this memorandum.

ISSUES

1. What is the extent of any allowable charitable contribution deduction under I.R.C. §170 with respect to real property located in Ohio and transferred by [REDACTED] to [REDACTED].
 - A. What is [REDACTED]'s interest in the property and improvements that can be the subject of a charitable contribution.
 - B. When did [REDACTED] satisfy the elements of a gift of the property under Ohio law and the Internal Revenue Code (Code).
 - C. Whether any transfer by [REDACTED] constitutes a transfer of a nonqualifying partial interest in property.

D. Whether the failure by [REDACTED] to include the value of the property in income prohibits a charitable contribution deduction.

E. Whether the provisions of I.R.C. §170(e) reduce the amount of any allowable contribution by the value of the building and improvements erected by [REDACTED].

F. Whether [REDACTED] complied with the substantiation requirements of I.R.C. §170(f)(8) and applicable regulations for the taxable year ended December 31, [REDACTED].

Facts - General

[REDACTED] is a [REDACTED] Limited Liability Company (LLC) in the business of real property acquisition, development, and leasing. [REDACTED]'s principal executive office is located in [REDACTED].

[REDACTED]: During [REDACTED], the following individuals held interests in [REDACTED]:

<u>Member/Member</u>	<u>Profit, Loss, Capital Interest</u>
[REDACTED] ([REDACTED])	[REDACTED] %
[REDACTED] ([REDACTED])	[REDACTED] %
[REDACTED] ([REDACTED])	[REDACTED] %

Because all [REDACTED] members are individuals and there is no evidence of any election into TEFRA, [REDACTED] is a small partnership excluded from applicability of the provisions of I.R.C. §6221 through §6234, inclusive (TEFRA). See I.R.C. §6231(a)(1)(B)(i) and §6231(a)(1)(B)(ii).

We assume that these members and their respective interests did not change in post-[REDACTED] years.

[REDACTED] is a cash method taxpayer that files Forms 1065 on a calendar year basis.

[REDACTED]'s Acquisition of Property

By [REDACTED], [REDACTED] purchased real property consisting of a [REDACTED]-acre parcel of land, a one-story brick building, and other improvements located at the end of [REDACTED], [REDACTED], Ohio [REDACTED] for cash of \$[REDACTED]. The other

improvements on the property included a [REDACTED]
[REDACTED].

[REDACTED], Ohio is located in a rural area of [REDACTED] Ohio.

[REDACTED]

[REDACTED] allocated the cost of the property as follows:

Land	\$ [REDACTED]
Building	<u>[REDACTED]</u>
Total	\$ [REDACTED]

[REDACTED]'s Lease of Property to [REDACTED]

By a lease agreement dated April __, [REDACTED] (lease agreement) and executed by [REDACTED], on [REDACTED]'s behalf, and [REDACTED] ([REDACTED]), as the [REDACTED], [REDACTED] leased its [REDACTED] property to [REDACTED] for use as a federally-funded [REDACTED] for a [REDACTED]-year term commencing [REDACTED].

[REDACTED], a [REDACTED] nonprofit corporation, is regulated by the United States Department of Health and Human Services (HHS). [REDACTED]'s principal executive office is located in [REDACTED].

The lease agreement defined the leased property as consisting of the [REDACTED]
[REDACTED]:

[REDACTED]

[REDACTED]

[REDACTED]

property.

[REDACTED]

Under the lease, [REDACTED] was obligated to pay monthly rent of \$[REDACTED] within [REDACTED] days of the end of each month and without any right in [REDACTED] of recoupment, setoff, or abatement. [REDACTED] agreed to pay the following additional items during the lease term:

[REDACTED]

[REDACTED]

[REDACTED]

The lease agreement defined rent as only amounts of money that [REDACTED] was obligated to pay as rent.

[REDACTED]

[REDACTED]

In the case of an event constituting default of [REDACTED]'s obligations under the lease agreement, [REDACTED]

terminate the lease and TMC's right of possession and use after the following events:

[REDACTED]

[REDACTED]

[REDACTED].

[REDACTED]

[REDACTED]

In addition, the lease agreement appears to provide that [REDACTED]

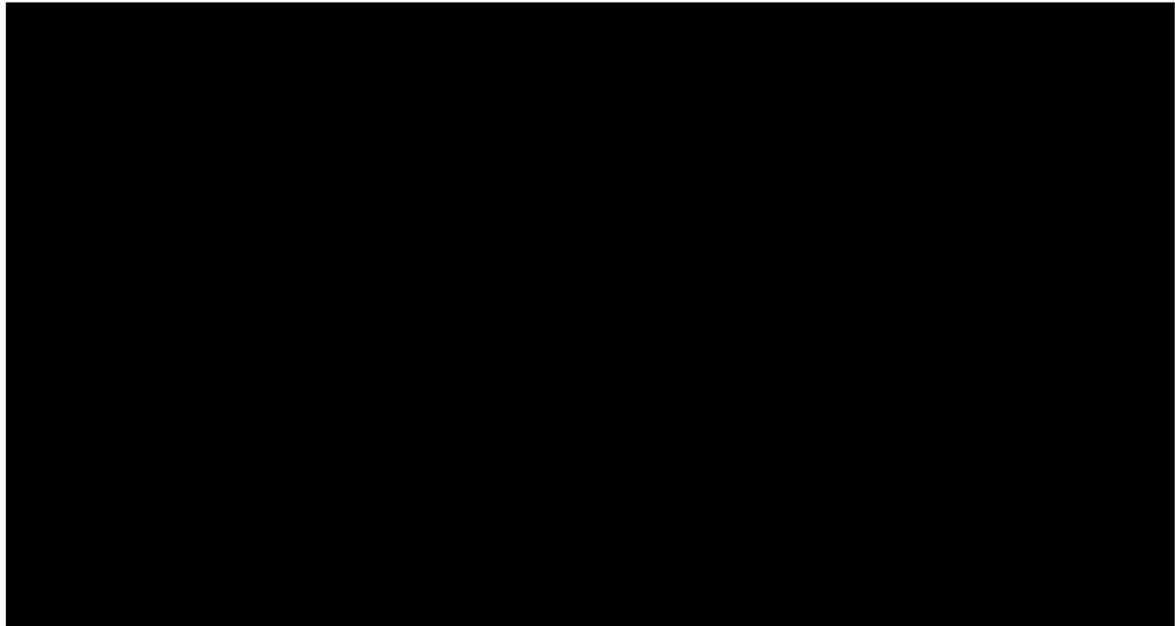
[REDACTED]

The lease agreement specifically stated [REDACTED]

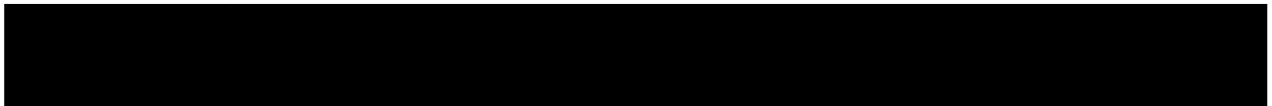
[REDACTED]

By "Amendment to Lease Agreement" dated [REDACTED]
(lease amendment) and executed by [REDACTED]
Member/Manager of [REDACTED], and [REDACTED] ([REDACTED]) as
[REDACTED]'s president, [REDACTED]

[REDACTED]. This lease amendment also provided the following:



The copy of the lease amendment provided [REDACTED]



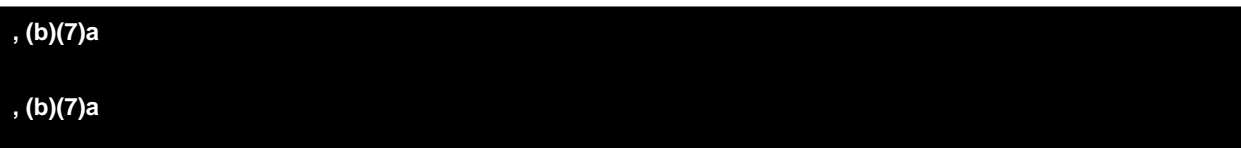
[REDACTED]. The file does not indicate the area code for or the owner of the telephone number reflected on the telefax cover sheet. The copy also reflects that [REDACTED]'s [REDACTED]



[REDACTED]. However, the file does not clearly reflect the date and time that the amendment was actually executed on behalf of either [REDACTED] or [REDACTED].

There is no acknowledgment of [REDACTED]'s execution of the lease or [REDACTED]'s execution of the lease amendment on [REDACTED]'s behalf as required by Ohio Revised Code Annotated §5301.01 (Anderson 2002). In addition, there are no signatures of witnesses to the execution of the lease agreement or its amendment. Furthermore, we understand that neither the lease agreement nor amendment was recorded.

There were never any events of default under the lease agreement and termination notices provided by [REDACTED] to [REDACTED].



█'s Improvements

By █, █ erected a █ consisting of █ at █'s expense on the property. █ contracted with █ to build the second building at a cost of \$█. Since completion of construction, █ has used the second building as part of its █ operations.

By █, the property also contained █
█.
However, the file does not indicate the date that these specific items were placed on the property or the identity of the person that paid for them.

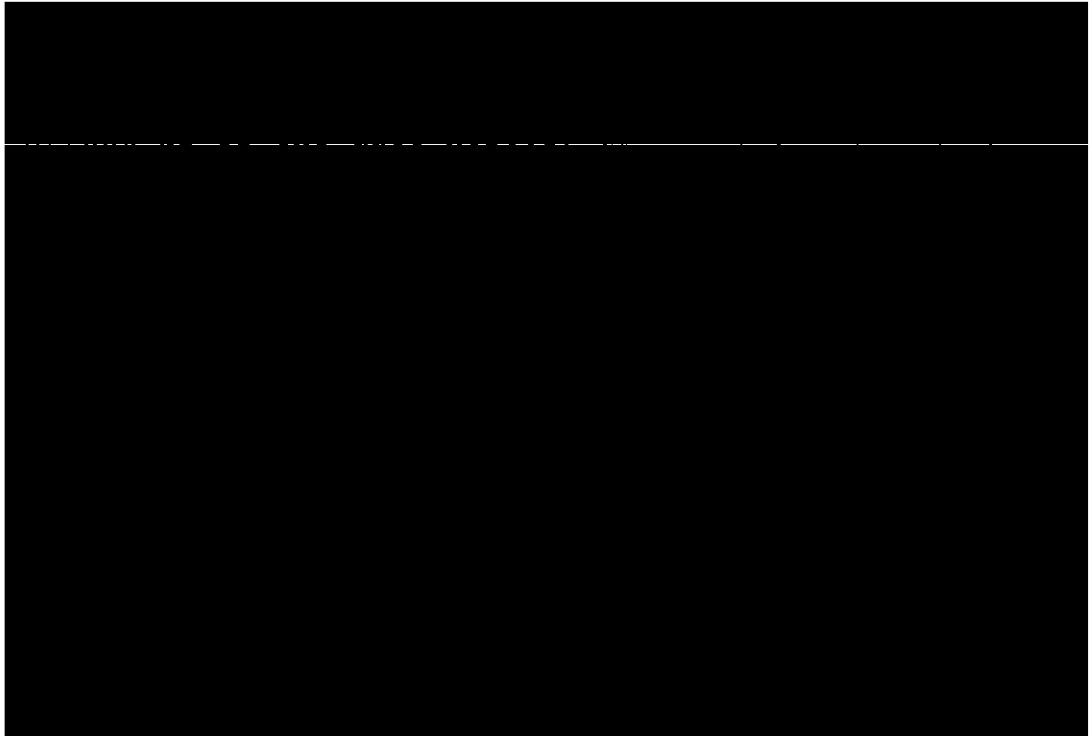
The file does not reflect that █ included the value of the building and other improvements or property affixed to the land by █ in income or basis for financial or tax purposes. In addition, there is no evidence that this building was in lieu of any rent to be paid █.

The file does not reflect whether the building constructed in █ and other improvements made by █ were considered taxable under Ohio law or on any list of exempt property maintained by the County Auditor for █, Ohio.

Bill of Sale

The file of the Internal Revenue Service (Service) contains two copies of a "Bill of Sale" dated █ purporting to transfer █'s interest in the improvements "(as defined in the [l]ease" as a charitable contribution to █. Both copies of this "Bill of Sale" recognized the █ lease agreement and reflected that █ and █ would simultaneously amend the lease to reflect the contribution.

The "Bill of Sale" specifically stated the following:



The "Bill of Sale" specifically provided that it was governed by and construed in accordance with Ohio law.

However, the first copy of the "Bill of Sale" bears only the signature of [REDACTED], as a member/manager of [REDACTED]. It reflects that the lease was dated [REDACTED] __, [REDACTED]. While this copy reflects a blank for the signature of an unidentified vice president of [REDACTED], it does not contain any signature on behalf of [REDACTED] or any date of receipt by [REDACTED]. The file does not reflect the identity of [REDACTED]'s vice president at the time.

The second copy of the "Bill of Sale" reflects that the lease was dated [REDACTED] and contains signature of [REDACTED], as a member/manager of [REDACTED], and [REDACTED], as [REDACTED]'s president, and a notation of receipt by TMP's Fiscal Department on [REDACTED].

Neither copy of the "Bill of Sale" contained the acknowledgment of the signature of [REDACTED]'s authorized representative as required by Ohio Revised Code Annotated §5301.01 or signatures of any witnesses.

's Post- Payments to or for

For the months of through , inclusive, paid rent at the monthly rate of \$ established in the lease agreement for both the land and . In , refunded the portion of the rent attributable to the improvements for the months of through . Pursuant to the lease amendment, \$.

 Property Tax Information

Records for , Ohio () reflect that the value of the land and improvements as of was as follows:

	<u>Value</u>
Land	\$
Building 1	
Building 2	
Driveways & Parking Area	
Total	\$

 assessed real property taxes for and in the respective amounts of \$ and \$ on the property. However, we do not know the exact property on which such taxes were assessed.

We do not know the assessed value of and taxes assessed on the property by for , , , and .

Appraisal Obtained By

In addition, secured an appraisal dated and prepared by () for the property. (b)(7)a

, (b)(7)a

, (b)(7)a

Based solely on an exterior inspection by [REDACTED], [REDACTED] determined the following values for the land and improvements:

<u>Item</u>	<u>Value</u>
Land	\$ [REDACTED]
Building 1	[REDACTED]
Building 2	[REDACTED]
Aggregate Value of [REDACTED], [REDACTED]	[REDACTED]
Total	\$ [REDACTED]

[REDACTED] used a cost approach to value the two buildings. He used the Marshall & Swift cost manuals for Class C Schools with average masonry construction to estimate the building values. [REDACTED] has not provided the basis of his appraisal of the value of the land and other improvements.

[REDACTED] did not use comparable sales or income approaches in his valuation, because he could not locate any comparable sales or rental properties. (b)(5)(DD) (b)(7)c

In the event that [REDACTED] retained only the land, [REDACTED] determined that fair rental value of only the land was \$[REDACTED] per year (\$[REDACTED] per month). Such rental value was based on aggregate rate of [REDACTED]% applied to [REDACTED]'s estimate of \$[REDACTED] for the land value.

, (b)(7)a

, (b)(7)a

[REDACTED]

[REDACTED]

, (b)(5)(DP), (b)(7)a

[REDACTED]

, (b)(5)(DP), (b)(7)a

[REDACTED]

■'s Basis Records

■'s records for its basis in the property reflected a basis of only its original cost less small deductions for depreciation. With the exception of the taxable year ■, we do not know the amount of depreciation for the property. In addition, we do not know the method of computing depreciation used by ■.

Relevant Tax Returns

The extended due date for ■'s ■ U. S. Partnership Return of Income (Form 1065) was ■. This return was postmarked ■. The Internal Revenue Service received ■'s ■ Form 1065 on ■.

On its ■ Form 1065, ■ reported the following income and expenses related to the property leased to ■:

Income	\$	■
Less Expenses:		
Utilities	\$	■
Depreciation		■
Licenses & Permits		■
Total expenses		■

On this Form 1065, ■ also claimed a charitable contribution of the real property \$■ under I.R.C. §170. Attached to the return was an incomplete Form 8283 (Noncash Charitable Contribution) reflecting ■'s EIN and ■'s SSN. In Section A, Part I, and Section B, Part 1 of the Form 8283 reflected that ■ had donated "■" located at "■, ■, Ohio ■". In addition, Section B, Part I reflected that, as of ■, the condition of the property was good and the property value was \$■.

signed the Declaration of Appraiser dated
in Section B, Part III.

, (b)(5)(DP), (b)(7)a

, (b)(5)(DP), (b)(7)a

However, Section A, Part I of such Form 8283 omitted the date of the contribution, the date and manner of's acquisition of the property, 's basis in the property, the property's fair market value, and the manner of determining such value. In addition, no appraisal of the property was attached to the return. Furthermore, no information was included in Section A, Part II, Line 2 (for donations of less than a taxpayer's interest in property) and Section B, Part IV (Donee Acknowledgment) of Form 8283. More specifically, no authorized representative of had executed the Donee Acknowledgment as required by Treasury Regulation §1.170A-13(c)(4)(iii).

allocated the claimed charitable contribution as follows:

<u>Member</u>	<u>Amount</u>
	\$
Total	\$

We do not know when supplied copies of the Form 8283 to its members. In addition, we do not know whether's members attached a copy of such Form 8283 to their personal income tax returns as required by Treasury Regulation §1.170A-13(c)(4)(iv)(G). However, even if's members did not comply with such requirement, we assume that they may correct the omission under the 90-day period prescribed by Treasury Regulation §1.170A-13(c)(4)(iv)(H).

We do not have sufficient information to address the following issues:

- a. Whether's members reported their allocable shares of the claimed contribution in accordance with the provisions

of I.R.C. §170, §702, and §703.

b. Whether [REDACTED]'s members made any elections that would affect any deductions under I.R.C. §170.

c. The extent to which the provisions of I.R.C. §1245 or §1250 apply to this case.

Examination by Service

By [REDACTED], Revenue Agent Ray Stone (Mr. Stone) was assigned to examine [REDACTED]'s 1065 and contacted [REDACTED].

After Mr. Stone's contact, [REDACTED] provided Mr. Stone with a copy of a warranty deed dated [REDACTED], executed by [REDACTED], as a [REDACTED] member/manager, and witnessed by [REDACTED] and [REDACTED] ([REDACTED]). [REDACTED] is a Notary Public in [REDACTED] and lawyer with the law firm of [REDACTED].

However, the warranty deed was not acknowledged until [REDACTED] by [REDACTED], as a notary, in accordance with Ohio Revised Code Ann. §5301.01.

By letter dated [REDACTED], [REDACTED] forwarded the warranty deed "which ha[d] been executed by [REDACTED] and which is now ready to be recorded" to [REDACTED], Inc. in [REDACTED] for review and filing. In this letter, [REDACTED] stated that [REDACTED] "now desires to transfer, by Gift Deed, the real estate" to [REDACTED].

On [REDACTED], [REDACTED] recorded the warranty deed transferring its interest in the property to [REDACTED]. The recorded warranty deed reflected that [REDACTED] paid a transfer tax of \$[REDACTED]. The amount of the transfer tax indicates that it was based solely on the value of the land and original school building when acquired by [REDACTED] during [REDACTED].

By telephone and letter dated [REDACTED], Mr. Stone requested the following information for the donation from [REDACTED] ([REDACTED]), [REDACTED]'s Chief Financial Officer (CFO):

a. [REDACTED]'s execution of the Donee Acknowledgment on a copy of the Form 8283 attached to [REDACTED]'s Form 1065.

b. A detailed description of the donated assets, the date that legal ownership was transferred to [REDACTED], and a copy of the relevant deed.

c. Date that [REDACTED] lease agreement terminated and the last full month that [REDACTED] made lease payments made under such agreement.

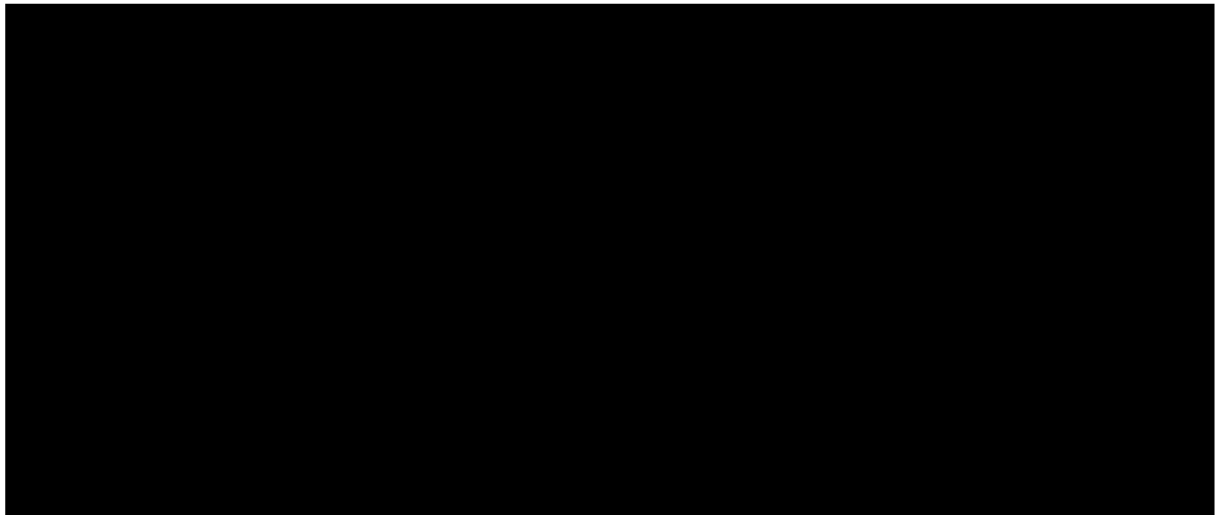
d. Any agreements, leases, contracts and other documents that clarify the intent as to the construction, ownership, and right to use the second building.

e. The value of the second building after completion of construction.

On [REDACTED], Mr. Stone received [REDACTED]'s letter dated [REDACTED] enclosing copies of a Form 8283 with Donee Acknowledgment executed by [REDACTED], [REDACTED]'s Chief Executive Officer (CEO) on [REDACTED] and [REDACTED]'s copies of the lease agreement, lease amendment, "Bill of Sale", and construction contract related to the second building. We have no information to reflect that [REDACTED] was not authorized to execute the Donee Acknowledgment.

The file does not indicate when [REDACTED] provided any Form 8283 to [REDACTED]. However, the file indicates that Mr. Stone first provided [REDACTED] with a Form 8283 during [REDACTED].

[REDACTED]'s letter dated [REDACTED] also reflected the following:



In [REDACTED], [REDACTED] and [REDACTED] advised Mr. Stone of the following:

a. [REDACTED] believed that it only received an interest in the improvements as described in the lease agreement and "Bill of Sale". [REDACTED] lacked any knowledge or documents indicating that the land had been contributed to [REDACTED].

b. [REDACTED]'s last payment of \$[REDACTED] for land rent to [REDACTED] occurred on [REDACTED] pursuant to the lease amendment.

c. On [REDACTED], [REDACTED] and [REDACTED] held the respective positions of [REDACTED]'s CEO and [REDACTED] Director. However, they are no longer employed in those capacities.

d. [REDACTED], who became [REDACTED]'s CEO in early [REDACTED], signed the Donee Acknowledgment after repeated requests by [REDACTED]'s accountants, but lacked personal knowledge of the transaction.

e. On [REDACTED], an unidentified [REDACTED] principal told [REDACTED] that [REDACTED]'s intent was to transfer the land and building to [REDACTED], but lacked any documentation to substantiate that asserted intent.

f. As of [REDACTED], [REDACTED] had not been provided with any deed related to [REDACTED]'s transfer of property to [REDACTED].

On about [REDACTED], [REDACTED] paid \$[REDACTED] to [REDACTED] as reimbursement for [REDACTED]'s "overpayment of rent" for the period from [REDACTED] through [REDACTED]. The transmittal letter for the [REDACTED] contained the following explanation:

[REDACTED]

[REDACTED]

[REDACTED]

Mr. Stone was provided with [REDACTED]'s appraisal during the Service's examination of [REDACTED]'s [REDACTED] Form 1065.

, (b)(5)(DP), (b)(7)a

, (b)(5)(DP), (b)(7)a

, (b)(5)(DP), (b)(7)a

For purposes of determining whether any amount is reduced by ordinary income or short-term capital gain on property under I.R.C. §170, there are insufficient facts to determine whether the provisions of I.R.C. §1245 or §1250 apply to make any portion of the unrealized gain on the property at the time of the contribution ordinary income.

Real property and tangible personal property that is owned by a charitable or educational institution and used exclusively for public purposes is exempt from real property tax imposed by the State of Ohio. Ohio Rev. Code Ann. §5709.08 and §5709.12.1 (Anderson 2002). Despite this exemption, we have no information reflecting that [REDACTED] has refunded any property tax paid by [REDACTED] on the property for [REDACTED] and [REDACTED].

Mr. Stone has complied with the notice of third party contact prescribed by I.R.C. §7602(c).

Although the warranty deed states that [REDACTED] received \$[REDACTED] in consideration for the transfer, we are assuming that the rules for bargain sales do apply to the transfer of any interest in the property to [REDACTED] based on such a negligible amount.

Until otherwise advised, we are assuming that none of [REDACTED]'s members made any elections that affect the amount of any allowable charitable deductions.

[REDACTED], (b)(5)(DP), (b)(7)a

[REDACTED], (b)(5)(DP), (b)(7)a

[REDACTED], (b)(5)(DP), (b)(7)a

[REDACTED], (b)(5)(DP), (b)(7)a

Issue 1 - Legal Discussion

A deduction is allowed for a contribution or gift to a qualified organization if payment of the contribution or gift is made during the taxable year. I.R.C. §170(a) and §170(c)(1).

Issue 1.A. - [REDACTED]'s Interest in Land & Improvements

A taxpayer's property interest is determined under applicable state law. Aquilino v. United States, 363 U.S. 509, 512-513 (1960); Morgan v. Commissioner, 309 U.S. 626 (1940); Warda v. Commissioner, 15 F.3d 533, 537 (6th Cir. 1994), cert. denied, 513 U.S. 808 (1994) (Michigan law); Greer v. Commissioner, 77 T.C. 294, 304 (1978), acq. 1979-1 C.B. 1, aff'd, 634 F.2d 1044 (6th Cir. 1980). Because the real property that is the subject of the disputed contribution is located in Ohio, Ohio law governs the extent of [REDACTED]'s interest in the property transferred to [REDACTED]. Alioto v. Commissioner, T.C. Memo 1980-360, aff'd, 692 F.2d 762 (9th Cir. 1982).

Elements of Valid Transfer of Ohio Real Property

The transfer of an ownership or leasehold interest in real property located in Ohio does not occur before completion of

all of the following actions:

- a. Execution of a written document by an authorized representative of the owner/lessor of the property.
- b. Acknowledgment of the signing by the grantor/lessor before a judge or clerk of a court of record in Ohio, or a county auditor, county engineer, notary public, or mayor, who shall certify the acknowledgment and subscribe the official's name to the certificate of the acknowledgment.
- c. Delivery of the executed deed to the transferee.
- d. Transferee's acceptance of the deed.

Ohio Rev. Code Ann. §1335.04 (Ohio Statute of Frauds) and §5301.01 (Statute of Conveyances) (Anderson 2002); Kniebbe v. Wade, 118 N.E.2d 833 (Ohio 1954); Candlewood Lake Association, Inc. v. Scott, 2001 Ohio 8873 (Ohio Ct. App. 2001); Bolles v. The Toledo Trust Co., 132 Ohio 21 (Ohio 1936); Delfino v. Paul Davies Chevrolet, Inc., 209 N.E.2d. 194 (Ohio 1965).

All deeds and written instruments for the conveyance of an interest in land also are required to be recorded in the office of the recorder of the county in which the land is located. Ohio Rev. Code Ann. §5301.25 (Anderson 2002). Until recorded, a document evidencing a transfer of an interest in land is fraudulent as to a bona fide purchaser without actual or constructive knowledge of such instrument. Ohio Rev. Code Ann. §5301.25 (Anderson 2002); Tiller v. Hinton, 482 N.E. 2d 946 (Ohio 1985). However, failure to record a long-term lease does not affect the validity of the lease between the parties. The Lithograph Building Co. v. Watt, 117 N.E. 25 (Ohio 1917).

Defectively Executed Leases

, (b)(5)(DP), (b)(7)a



, (b)(5)(DP), (b)(7)a

, (b)(5)(DP), (b)(7)a



, (b)(5)(DP), (b)(7)a

, (b)(5)(DP), (b)(7)a

Rights in Improvements and Additions to Real Property

Real property generally include land and all buildings, structures, improvements, and fixtures of whatever kind on the land. Ohio Rev. Code Ann. §5701.02(A) (Anderson 2002). A building is a permanent fabrication or construction attached to land that consists of "foundations, walls, columns, girders, beams, floors, and a roof" that is intended as habitation or shelter for people or tangible personal property for which it is designed to shelter. Ohio Rev. Code Ann. §5701.02(B)(1) (Anderson 2002).

A structure is a permanent fabrication or construction other than a building that is attached to the land that increases or enhances use or enjoyment of the land. Ohio Rev. Code Ann. §5701.02(B)(E) (Anderson 2002). Structures include, but are not limited to, dams, fences, and walls. Ohio Rev. Code Ann. §5701.02(E) (Anderson 2002).

An improvement is a permanent addition, enlargement, or alteration that is generally considered a part of a building or structure. Ohio Rev. Code Ann. §5701.02(D) (Anderson 2002).

A fixture is an item of tangible personal property that does not constitute real property, but is permanently attached to the land or a building, structure, or improvement and primarily benefits the realty and not the business conducted by the occupant on the premises. Ohio Rev. Code Ann. §5701.02(B)(2)(C).

Business fixtures are excluded from the definition of real property. Ohio Rev. Code Ann. §5701.03(A) (Anderson 2002). Business fixtures include, but are not limited to,

those portions of buildings, structures, and improvements that are specially designed, constructed, and used for the business conducted in the building, structure, or improvement. Ohio Rev. Code Ann. §5701.03(B) (Anderson 2002). However, business fixtures do not include fixtures that are common to buildings and primarily benefit the realty and not the business conducted by the occupant on the premises. Ohio Rev. Code Ann. §5701.03(B) (Anderson 2002).

For a building or improvement erected on land by a lessee to constitute realty and not a business fixture, the following three requirements must be satisfied:

- a. Annexation to the land or something appurtenant thereto.
- b. Appropriation to the use or purpose of that part of the realty to which it is connected.
- c. Lessee's intention to make the building or improvement a permanent part of the realty.

Litton Systems, Inc. v. Tracy, 728 N.E.2d 389 (Ohio 2000) (easily removable equipment used to handle business merchandise was personal property); Zangerle v. Republic Steel Corp., 60 N.E.2d 170 (Ohio 1945); Teaff v. Hewitt, 1 Ohio St. 511 (Ohio 1853); Willis v. Beeler, 90 F.2d 538, 541 (6th Cir. 1937).

The requisite intention is determined from the nature of the affixed item, the relation and situation of the person attaching the article, the structure and mode of annexation, and the purpose and use for which affixed. Litton Systems, Inc., 728 N.E.2d 389 (no intent when occupant could easily remove, replace, and reconfigure equipment without damage to building); Teaff, 1 Ohio St. 511; Zangerle, 60 N.E. 170 (Ohio 1945).

When a lessee erects expensive structures for carrying on the lessee's business and the structures can be removed without destruction or material injury to the land or other structures, there is a presumption that the tenant did not intend to make the building a permanent part of the realty. Teaff, 1 Ohio St. 511; Round v. Plating & Galvanizing Co., 17 Ohio Op. 464 (Common Pleas Court, Cuyahoga County, Ohio 1940) (lessee and lessor treated buildings erected as the lessee's property in financial and tax records).

In addition, ownership of improvements and additions on real property constructed by the lessee at the lessee's expense become property of the lessor only at the time the lease so specifies. Visicon, Inc. v. Tracy, 699 N.E.2d 89 (Ohio 1998) (lease provided that lessor's interest was only in the land and that lessee, who constructed improvements at lessee's expense and possessed obligation to remove them at lease end, was owner during and after termination of lease); In re Application for Exemption of Real Property from Taxation: Carney, Aud. v. City of Cleveland, 180 N.E.2d 14 (Ohio 1962) (lessee under leases for 25 to 40 years and who were to construct at their own expense aircraft hangers for use of lessee deemed owner of improvements).

Issue 1.A. - Application of Law to Facts

As of [REDACTED], [REDACTED] owned only a reversionary interest in the land and buildings and other improvements on the property at the commencement of the lease. [REDACTED]'s reversionary interest existed in accordance with the terms of the [REDACTED] lease agreement.

[REDACTED]
, (b)(5)(DP), (b)(7)a

[REDACTED]
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[REDACTED]
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[REDACTED]

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Issue 1.B. - Elements of Valid Gift

Under Ohio law, the essential elements of a gift are (a) the donor's intent to make an immediate gift, (b) delivery of the property to a donee, and (c) acceptance of the gift by the donee. Bolles v. The Toledo Trust Co., 4 N. E.2d 917 (Ohio 1936); Streeper v. Myers, 7 N.E.2d 554 (Ohio Ct. App. 1937). In the absence of fraud, duress, or undue influence, a gift is irrevocable upon delivery. Candlewood Lake Association, Inc. v. Scott, 2001 Ohio 8873 (Ohio Ct. App. 2001); Romaniw-Dubas v. Georgepolowyk, 2000 Ohio App. LEXIS 3613 (Ohio Ct. App. August 10, 2000).

An effective delivery of a gift of real property requires acceptance by the grantee and the grantor's intent to effect a present, immediate and unconditional transfer of title to the

property described in the deed. Kniebbe, 118 N. E.2d 833; Meeks v. Stillwell, 44 N.E. 267 (Ohio 1896) (lack of requisite intent); Candlewood Lake Association, Inc., 2001 Ohio 8873.

Presumptions of effective delivery arise under the following circumstances:

- a. Recordation of a deed. Raccoon Development, Inc. v. United States, 391 F.2d 610, 613 (Ct. Cl. 1968); Mitchell v. Ryan, 3 Ohio St. 377 (Ohio 1854) (recording is prima facie evidence of delivery); Candlewood Lake Association, Inc., 2001 Ohio 8873 (recording of a deed generally perfects delivery and makes the gift irrevocable); Romaniw-Dubas, 2000 Ohio App. LEXIS. 3613 (no issue as to intent, acceptance, or delivery).
- b. Possession of the deed by the named grantee or agent of such grantee. Mitchell, 3 Ohio St. 377; Kniebbe, 118 N. E.2d 833.

However, the key factor is the intention of the parties to effect a present transfer of the property described in the deed. Raccoon Development, Inc., 391 F.2d at 613. Therefore, even if the deed has been recorded or the grantee possesses the deed, the required intent does not exist when the grantor retains the right to control or reclaim a deed. Raccoon Development, Inc., 391 F.2d at 313 (despite recordation of deed on January 20, 1961, deed not delivered to purchaser until after May 1, 1961); Kniebbe, 118 N. E.2d 833 (grantor's fatal control evidenced by his full access to safety deposit box in which unrecorded deeds deposited; removal of some deeds from box and destruction of them; and grantee's failure to record deeds for at least six years after execution and acknowledgment).

A grantee's acceptance is established by the grantee's actions that are consistent with ownership of property. Candlewood Lake Association, Inc., 2001 Ohio 8873. These actions include holding oneself out as the owner of the property in subsequent transactions related to the property and asset statements, payment of fees, assessments and taxes related to the property. Candlewood Lake Association, Inc., 2001 Ohio 8873 (actions refuted assertions of no acceptance).

In the case of a gift of real property, a presumption of acceptance arises if the transfer is beneficial to the grantee

in the absence of contrary evidence. Candlewood Lake Association, Inc., 2001 Ohio 8873 (transfer from father to son). This presumption applies even if the grantee is not aware of the transfer. Candlewood Lake Association, Inc., 2001 Ohio 8873.

Requirements for a Charitable Contribution Deduction

When a transfer occurs between a competent donor and donee, the donor generally is not entitled to a deduction for a charitable contribution under I.R.C. §170 absent evidence of the following matters:

- a. The donor's clear, unmistakable intent to absolutely and irrevocably divest itself of the title, dominion, and control of the subject matter of the gift in praesenti.
- b. The irrevocable transfer of present legal title and of the dominion and control of the entire gift to the donee so that the donor can exercise no further act of dominion and control over it.
- c. Donor's delivery to donee of subject of gift or of the most effectual means of commanding the dominion of it.
- d. Donee's acceptance of the gift.

Estate of Whitt v. Commissioner, 751 F.2d 1548, 1560 - 1561 (11th Cir. 1985), cert. denied, 474 U.S. 1005 (1985); Goldstein v. Commissioner, 89 T.C. 535, 541-542 (1987); Guest v. Commissioner, 77 T.C. 9, 15-16 (1981), acq., 1982-1 C.B. 1; Weil v. Commissioner, 31 B.T.A. 899, 906 (1934), aff'd, 82 F.2d 561 (5th Cir. 1936), cert. denied, 299 U.S. 512 (1936).

Ordinarily, a contribution is made at the time of delivery. Treas. Reg. §1.170A-1(b). Delivery of a gift of real property is completed once the donor has delivered an executed deed transferring title to the property to the donee or donee's agent. Estate of Mortimer v. Commissioner, 17 T.C. 579, 583 (1951); Guest, 77 T.C. at 16 - 18 (donor retained substantial control of property until time of delivery of deed to donee's agents); Alioto, T.C. Memo 1980-360 (donor failed to record or provide donee with deed until subsequent year); Baxter v. Commissioner, T.C. Memo 1982-515; Dyer v. Commissioner, T.C. Memo 1990-51; Brotzler v. Commissioner, T.C. Memo 1982-615 (undelivered deed ineffective to transfer

dominion and control); Douglas v. Commissioner, T.C. Memo 1989-592 (donee possessed executed and acknowledged deed and acknowledged receipt of interest in real property).

However, a taxpayer cannot establish the requisite intent to irrevocably transfer its title, dominion and control over real property when the taxpayer retains significant rights of ownership, possession, and control of the property. Estate of Mortimer v. Commissioner, 17 T. C. 579, 583-584(1951) (donor continued to receive and use rental income from property, made repairs to the property, reported this income and claimed deductions on his tax returns); Baxter v. Commissioner, T.C. Memo 1982-515 (taxpayers continued to act as owners of property by reporting income, expenses and losses from rental of property and gain on sale of property; signing, as sellers of property, sales agreement, real estate listing, closing statement, and deeds; and maintaining insurance in their names); Brotzler, T.C. Memo 1982-615 (donor's continuing obligation to pay property taxes); Dalton v. Commissioner, T.C. Memo 1973-160 (taxpayer retained right and continued to use land as parking lot and made tax and mortgage payments); Dyer, T.C. Memo 1990-51 (donor-lessor continued to observe approval process set forth in lease).

However, the retention of an insignificant benefit will not preclude a deduction under I.R.C. §170. Glick v. Commissioner, T.C. Memo 1997-65 (special use permit allowing taxpayer to continue growing and harvesting crop was insignificant retained benefit with minimal value).

At least one appellate decision outside the Sixth Circuit has held that an irrevocable transfer of real property does not until a deed is recorded because only recording protects against subsequent disposition. Whitt, 751 F.2d at 1561 (failure to record deeds to Alabama property for several years after execution).

Events that occur after the purported date of execution reflected on a document transferring legal title to real estate can refute the earlier purported date on the document. Guest, 77 T.C. at 18 (later date of acknowledgment by donor in 1970 refuted earlier date on deed in 1969); Alioto, T.C. Memo 1980-360 (when donor retained and failed to record executed deeds, delivery to donees who had agreed to accept donations occurred on recording).

Acceptance of a gift by a donee is established when there is credible evidence that the donor intended to give and donee intended to receive the subject of gift. Douglas, T.C. Memo 1989-592 (corroborating testimony of intent to give and receive); Dalton, T.C. Memo 1973-160 (donee did not believe that it received present gift; taxpayer merely telephoned donee on evening of 12/31/1967 to inform of donee of desire to make gift); Alioto, T.C. Memo 1980-360 (donee agreed to accept the donation).

Issue 1.B. - Application of Law to Facts

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Issue 1.C. - Prohibition of Charitable Contribution Deduction
for Transfer of Partial Interest in Property

A charitable deduction is denied for gifts (not in trust) to charity in which the taxpayer donates less than its entire interest in the property. I.R.C. 170(f)(3)(A).

In this case, the only potentially relevant exception to this general prohibition is a contribution of an undivided portion of the taxpayer's entire interest in the property. I.R.C. §170(f)(3)(B)(ii); Treas. Reg. §1.170A-7(b)(1)(i). An undivided portion of a donor's entire interest consists of all or a fraction or percentage of each and every substantial interest or right owned by the donor in the property for the entire period of the donor's interest in the property. Treas. Reg. 1.170A-7(b)(1); Stark v. Commissioner, 86 T.C. 243, 252 (1986).

A donor is not entitled to a charitable deduction when it carves out and contributes only a portion of his interest in property. Rev. Rul 88-37, 1988-1 C.B. 97, 98.

The test for determining the substantiality of the retained interest or rights is whether the retained rights have

substantial value and the extent of potential interference with the donee's interest. Treas. Reg. 1.170A-7(a)(3); Stark, 86 T.C. at 252-255.

With respect to real property, a taxpayer makes a qualifying donation of a partial interest only when the donated interest is the only interest owned by the taxpayer in the property at the time of the donation. Treas. Reg. 1.170A-7(b)(i); Rev. Rul. 88-37, 1988-1 C.B. 97, 98 (taxpayer transferred overriding royalty or net profits interest, but retained right to control development and mineral rights lease); Rev. Rul. 76-331, 1976-2 C.B. 52, 53 (retention of all mineral rights in and right to receive rental income from long-term lease of land were prohibited retained interests); Rev. Rul. 76-253, 1976-2 C.B. 51, 52 (retention of timber cutting rights was substantial retained right); Rev. Rul. 75-420, 1975-2 C.B. 78, 79 (gift of only life interest in real property, where taxpayer owns the entire fee, is prohibited partial interest); Rev. Rul. 88-37, 1988-1 C.B. 97, 98 (partial interest must be taxpayer's entire interest before transfer to charity); Rev. Rul. 58-261, 1958-1 C.B. 143 (deduction allowed to extent of percentage of donated interest in both improvements and underlying land).

However, if the rights retained by the taxpayer are insubstantial or of minimal value, the retained interest will not constitute a prohibited partial interest. Greene, 864 F. Supp. at 414; Stark, 86 T.C. at 252; Rev. Rul. 76-331, 1976-2 C.B. 52, 53; Rev. Rul. 75-373, 1975-2 C.B. 77, 78 (retained mining rights that were subject to severe restrictions deemed insubstantial). Substantial restrictions on the donor's retained interest and the unlikely possibility that donor will benefit from the retained interest minimize the value of any retained interest. Rev. Rul. 75-66, 1975-1 C.B. 85, 86 (retained rights subject to restrictions by donee); Rev. Rul. 77-148, 1977-1 C.B. 63, 64 (donor's exercise of retained timber and mineral rights conditioned by approval of donee and possibility of approval was remote and negligible); Stark, 86 T.C. at 252-254 (donor's retained interest had minimal value when it was subject to substantial restrictions and there was remote possibility of interference with donee's interest).

An impermissible partial interest includes, but is not limited to, the right to use property rent-free. I.R.C. §170(f)(3)(A); Treas. Regs. 1.170A-7(a) and 1.170A-7(d), Ex. 1 (rent-free use of top floor of ten-story building for one-

year); Mathis v. Commissioner, T.C. Memo 1986-210 (no deduction allowed for rental value over three years when taxpayer did not report in income the amount of forgiven rents from real property); Logan v. Commissioner, T.C. Memo 1994-445 (deductions denied for rent-free use of garage to store fire engine owned by county government); Peters v. Commissioner, T.C. Memo 1976-170 (free-free right to use portion of office space leased by taxpayer-partnership on monthly basis). A rent-free right to use property is a prohibited partial interest regardless of the frequency and exclusivity of the right. Logan, T.C. Memo 1994-445.

The purpose of the prohibition on deductions for rent-free use of property is to disallow a double tax benefit of a deduction and exclusion from income of the amount of forgone rental income to a taxpayer who donated the use of property to a charity for a limited period of time. H. R. Rep. No. 91-413 (1969), reprinted in 1969-3 C.B. 200, 237; S. Rep. No. 91-552 (1969), reprinted in 1969-3 C.B. 423, 477; Greene v. United States, 864 F. Supp. 407, 412-413 (S.D.N.Y. 1994), aff'd on other grounds, 79 F.3d 1348 (2d Cir. 1996) (intent did not extend to transfer portion of commodities futures contracts representing long-term capital gains); Stark, 86 T.C. at 249.

Issue 1.C - Application of Law to Facts

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, (b)(5)(DP), (b)(7)a

Issue 1.D. - Limitation Based on Failure to Recognize Income
Attributable to Improvements by Lessee

When improvements erected and paid for by a lessee are not intended to be rent for the use of property, a lessor's income and basis for determining gain or loss on the property on which the improvements are erected do not include the cost or value of such improvements. I.R.C. §109, 1019, and §1011; M. E. Blatt Co. v. United States, 305 U.S. 267, 277-278 (1938); Carolina, Clinchfield & Ohio Railway Co., 82 T. C. 888, 902-905 (1984), aff'd on other grounds, 823 F.2d 33 (2d Cir. 1987).

In addition, when a cash method taxpayer fails to report the rental value of rent-free use of real property in income, the taxpayer may not deduct such rent-free use under I.R.C. §170. Mathis, T.C. Memo 1986-210.

Issue 1.C. - Application of Law to Facts

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Issue 1.E. - Reduction for Short-Term Capital Gain
or Ordinary Income Part of Value

The amount of any charitable contribution of property otherwise taken into account under I.R.C. §170 is reduced by the amount of gain that would not have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value at the time of the contribution. I.R.C. §170(e)(1); Holcombe v. Commissioner, 73 T.C. 104, 112 (1979). Thus, if the property donated to charity would have resulted in ordinary income or short-term capital gain to the donor had the donor sold the property, the allowable charitable contribution would be limited to the donor's adjusted basis in the property. Treas. Reg. §1.170A-4(b)(1); Porter v. United States, 738 F.2d 731, 733 (6th Cir. 1984); Lary v. United States, 787 F.2d 1538, 1540 (11th Cir. 1986); Morrison v.

Commissioner, 71 T. C. 686, 687-688 (1979), aff'd per curiam, 611 F.2d 98 (5th Cir. 1980); Glen v. Commissioner, 79 T. C. 208, 211-212 (1982).

During 1999, long-term capital was defined as gain from the sale or exchange of a capital asset held for more than one year. I.R.C. §1222(3).

Except to the extent to which I.R.C. §1245 and §1250 apply to recognize ordinary income, property used by a taxpayer in its trade or business is treated as a capital asset. I.R.C. §170(e)(1).

Issue 1.E. - Application of Law to Facts

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Issue 1.E. - Lack of Substantial Compliance
with Substantiation Requirements

No charitable contribution is allowed for any contribution unless the taxpayer substantiates the contribution in accordance with regulations prescribed by the Service. I.R.C. §170(a). In addition, no deduction is allowed for gifts of property with a value of \$250.00 or more unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgment of the contribution by the donee. I.R.C. §170(f)(8)(A); Treas. Reg. §1.170-13(f)(1); Addis v. Commissioner, 118 T.C. No. 32 (2002).

When a entity that is a partnership for tax purposes is

the donor of the contribution, the partnership is treated as the taxpayer for purposes of the substantiation requirements of I.R.C. §170(f)(8). Treas. Reg. §1.170A-13(f)(15). Thus, the partnership, and not its partners, is required to secure the required written donee acknowledgment before reporting the contribution on its return for the year of the contribution. Treas. Reg. §1.170A-13(f)(15).

The donee acknowledgment for property other than cash must generally contain the following:

- a. A description of the property transferred to the donee.
- b. A statement that the donee did not provide any goods or services in consideration, in whole or in part, for the property contributed.

I.R.C. §170(f)(8)(B); Treas. Reg. §1.170-13(f)(2).

To be contemporaneous, the acknowledgment must be obtained by the taxpayer no later than the extended due date for filing the return. I.R.C. §170(f)(8)(C); Treas. Reg. §1.170A-13(f)(3). An acknowledgment secured by the taxpayer after filing the original return for the year of the contribution is not contemporaneous. T.D. 8690, 1997-1 C.B. 68, 71.

As long as the written acknowledgment contains the information required by law, the acknowledgment may be in any form. T. D. 8690, 1997-1 C.B. at 71.

For a charitable contribution deduction of more than \$5,000.00, the donor must also satisfy the following relevant substantiation requirements:

- a. Obtain a qualified appraisal prepared, signed, and dated by a qualified appraiser for the contributed property not earlier than 60 days of the date of the contribution and not later than the due date (including extensions) of the first original return on which the deduction is claimed.
- b. Attach a fully completed appraisal summary to the tax return on which the deduction is first claimed.

Treas. Regs. §1.170A-13(c)(1), §1.170A-13(c)(2)(i)(A), §1.170A-13(c)(2)(i)(B), §1.170A-13(c)(3)(i)(A), §1.170A-13(c)(3)(i)(B), §1.170A-13(c)(3)(iv)(B).

The contents of a qualified appraisal must contain the following information relevant to identifying the extent of the property interest transferred to the donee and any interest retained by the donor:

a. A description of the property that is sufficiently detailed for a person which is not generally familiar with the property to ascertain that the appraised property is the property that was or will be contributed.

(b) The terms of any agreement or understanding entered into (or expected to be entered into) by or on behalf of the donor or donee that relates to the use, sale, or other disposition of the contributed property. Such an agreement includes, but not limited to, any agreement that restricts temporarily or permanently a donee's right to use or dispose of the property, reserves or confers on anyone other than the donee any right to income from the contributed property, or earmarks the property for a particular use.

Treas. Regs. §1.170A-13(c)(3)(i)(C), §1.170A-13(c)(3)(ii)(A), and §1.170A-13(c)(3)(ii)(D).

The required appraisal summary must be on a form prescribed by the Service and signed and dated by the donee and the appraiser who prepared the qualified appraisal. Treas. Reg. §1.170A-13(c)(4)(i)(A), §1.170A-13(c)(4)(i)(B), and §1.170A-13(c)(4)(i)(C). The appraisal summary must contain the type of property description required for a qualified appraisal. Treas. Regs. §1.170A-13(c)(4)(i)(D), §1.170A-13(c)(4)(ii)(B).

In addition, the appraisal summary must contain the following information relevant to determining whether the donor satisfied the substantive elements for completion of a charitable gift:

a. The date and manner of acquisition of the property by the donor.

b. The donor's basis in the property as provided by I.R.C. §1016.

c. The name, address, and taxpayer identification number of the donee.

- d. The date that the donee received the property
- e. Signature of authorized official of donee acknowledging the receipt of the gift.

Treas. Regs. §1.170A-13(c)(4)(i)(D), §1.170A-13(c)(4)(ii)(D) through §1.170A-13(c)(4)(ii)(G), inclusive, and §1.170A-13(c)(4)(ii)(M) (required by Form 8283), §1.170A-13(c)(4)(iii), §1.170A-13(c)(5)(i).

The appraisal summary must be provided to the donee. Treas. Reg. §1.170A-13(c)(4)(iv)(E).

If the contribution is of a partial interest in property, the appraisal must be of the partial interest. Treas. Reg. §1.170A-13(c)(2)(A).

Substantial, rather than strict, compliance with the substantiation requirements of Treasury Regulations issued under I.R.C. §170(f)(8) is required. Bond v. Commissioner, 100 T.C. 32, 41-42 (1993) (despite failure to attach qualified appraisal to return, compliance found because attached Form 8283 contained most of the required information and could be treated as written appraisal). However, failure to secure a qualified appraisal with substantially none of the required information is fatal to a claimed deduction. Hewitt v. Commissioner, 109 T.C. 258, 264-265 (1997), aff'd with unpublished opinion, 166 F.3d 332 (4th Cir. 1998) (taxpayers failed to secure qualified appraisal and attach a qualified appraisal summary to the return); D'Arcangelo v. Commissioner, T.C. Memo 1994-572 (taxpayers failed to secure qualified appraisal and attach a qualified appraisal summary to the return).

In addition, when the taxpayer fails to satisfy a requirement as to the substantive element of the deduction and the required substantiation incorrectly reflects satisfaction of the substantive element, the Tax Court recently held that taxpayer did not substantially comply with the substantiation requirements and disallowed a claimed deduction. Addis, 118 T.C. No. __ (deduction disallowed for failure to comply with substantiation requirements when donee incorrectly stated that donor did not receive any benefits from donee).

Issue 1.F. - Application of Law to Facts

, (b)(5)(DP), (b)(7)a



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Our conclusion is supported by five factors. First, at all

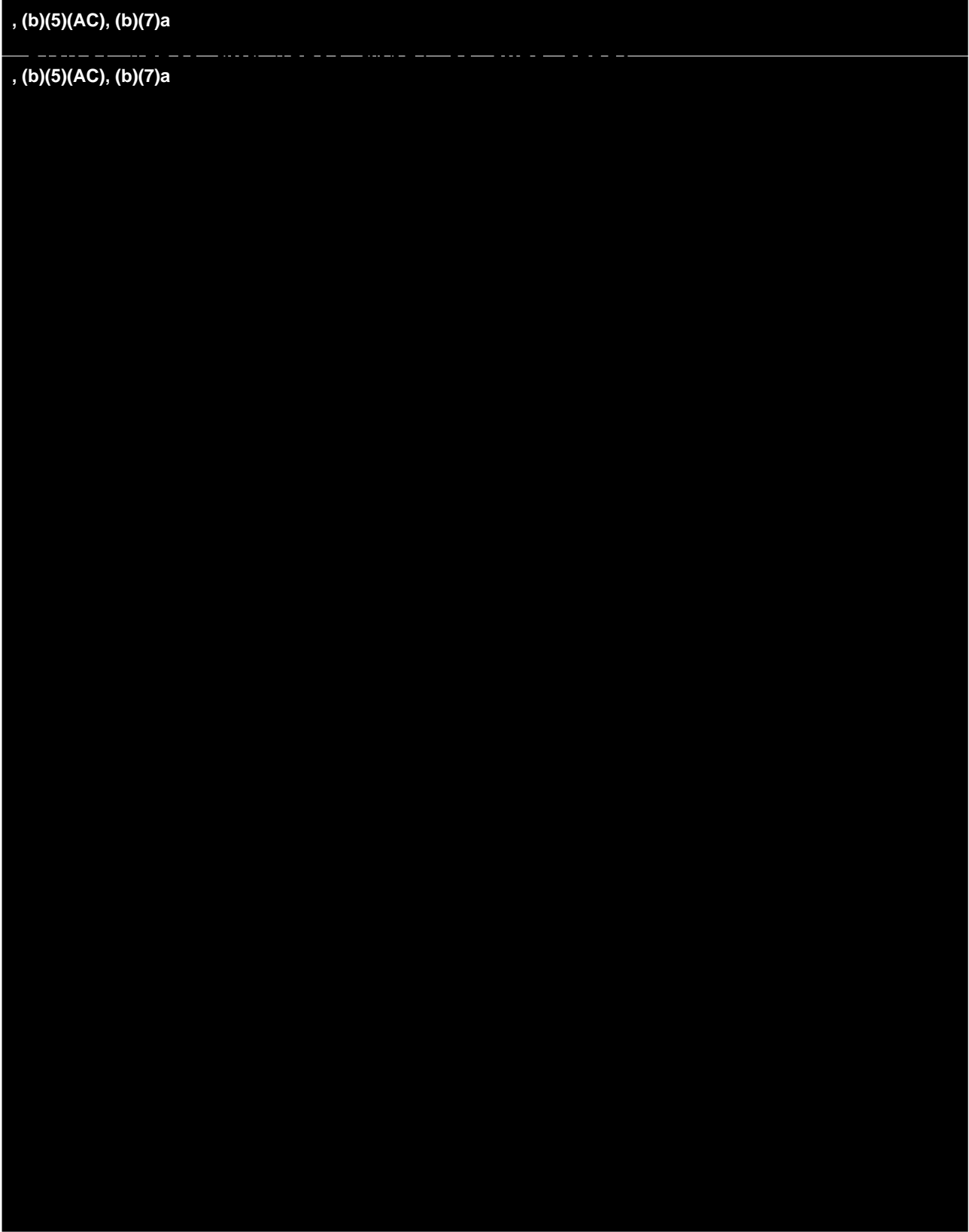
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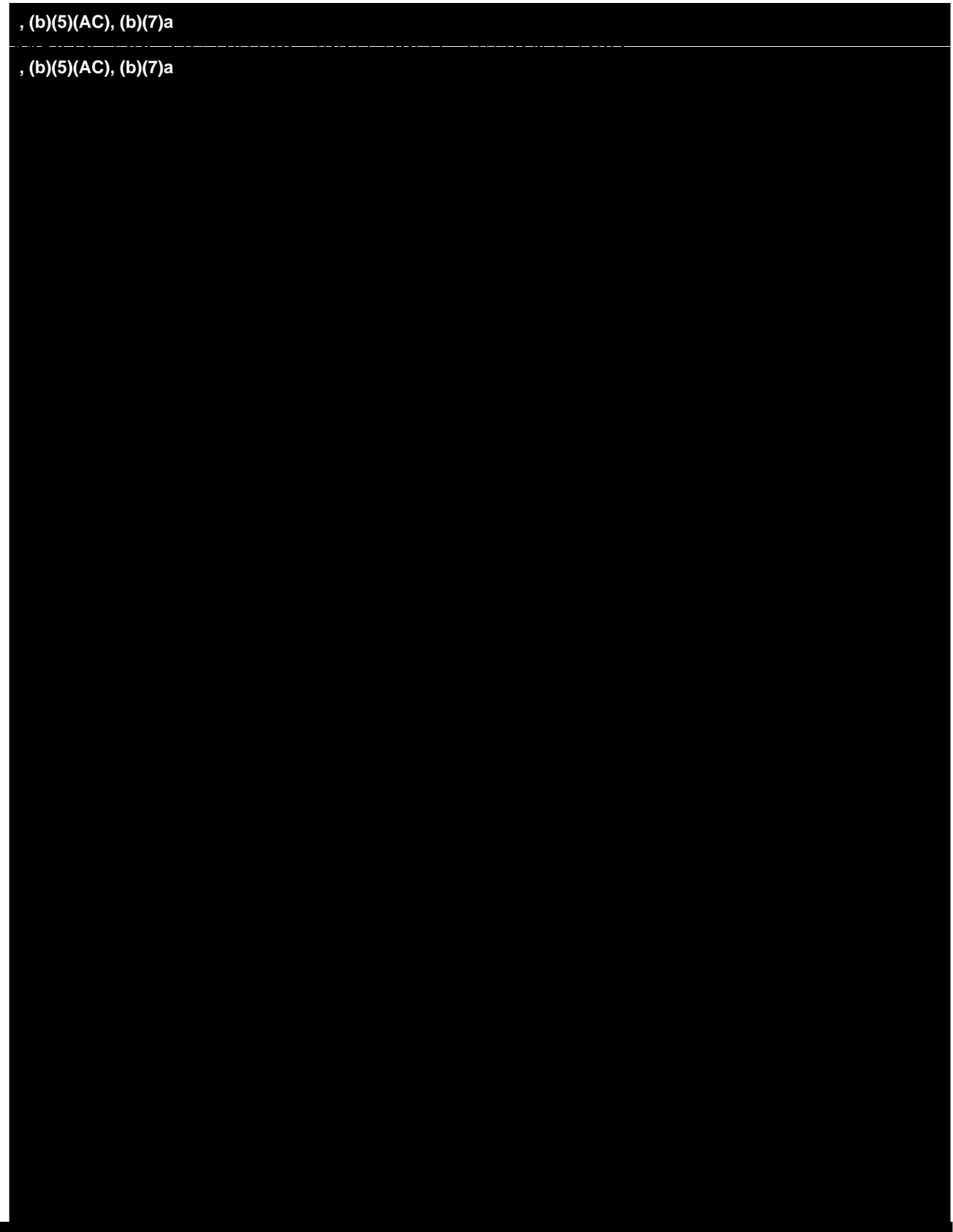
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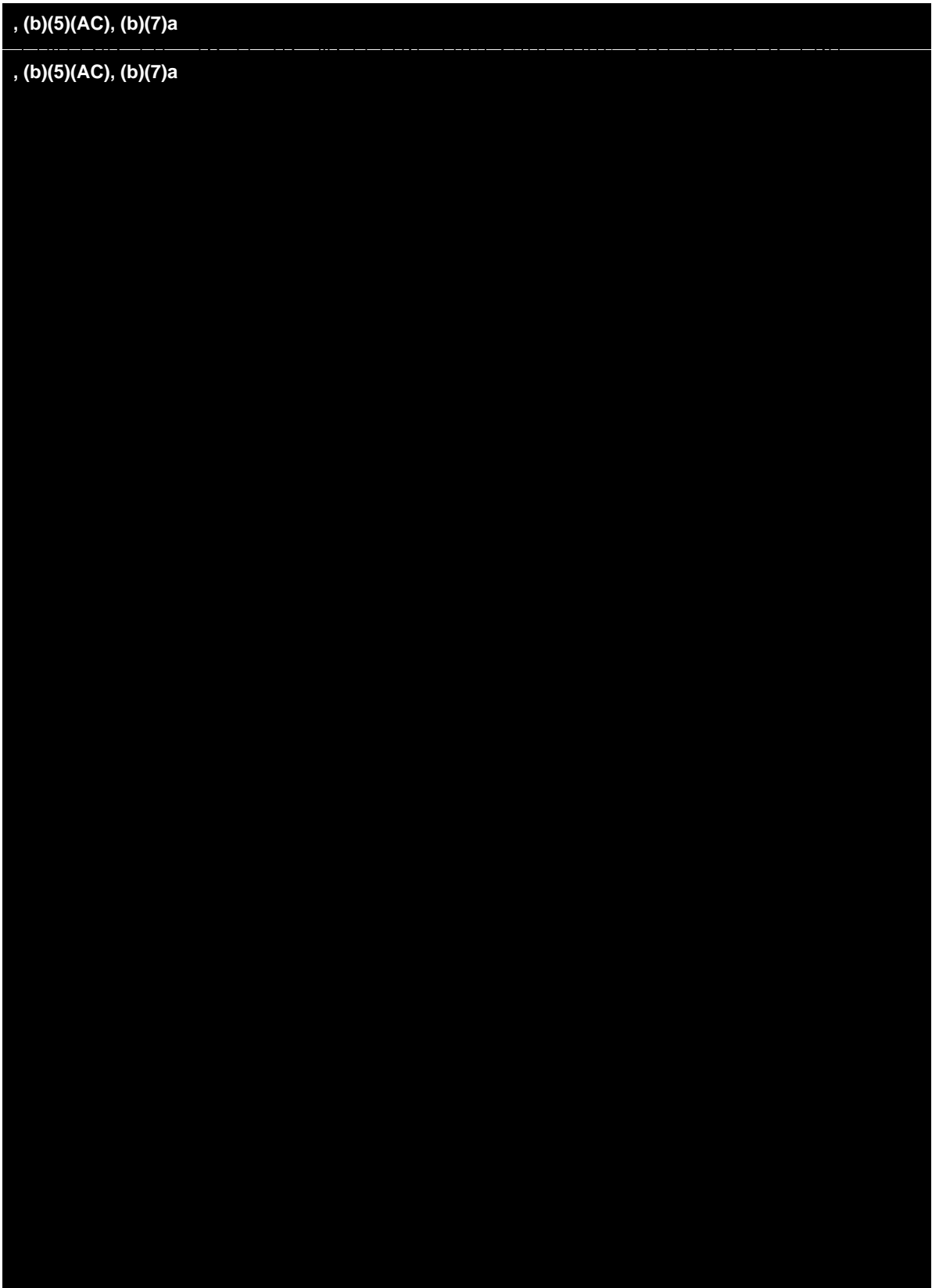
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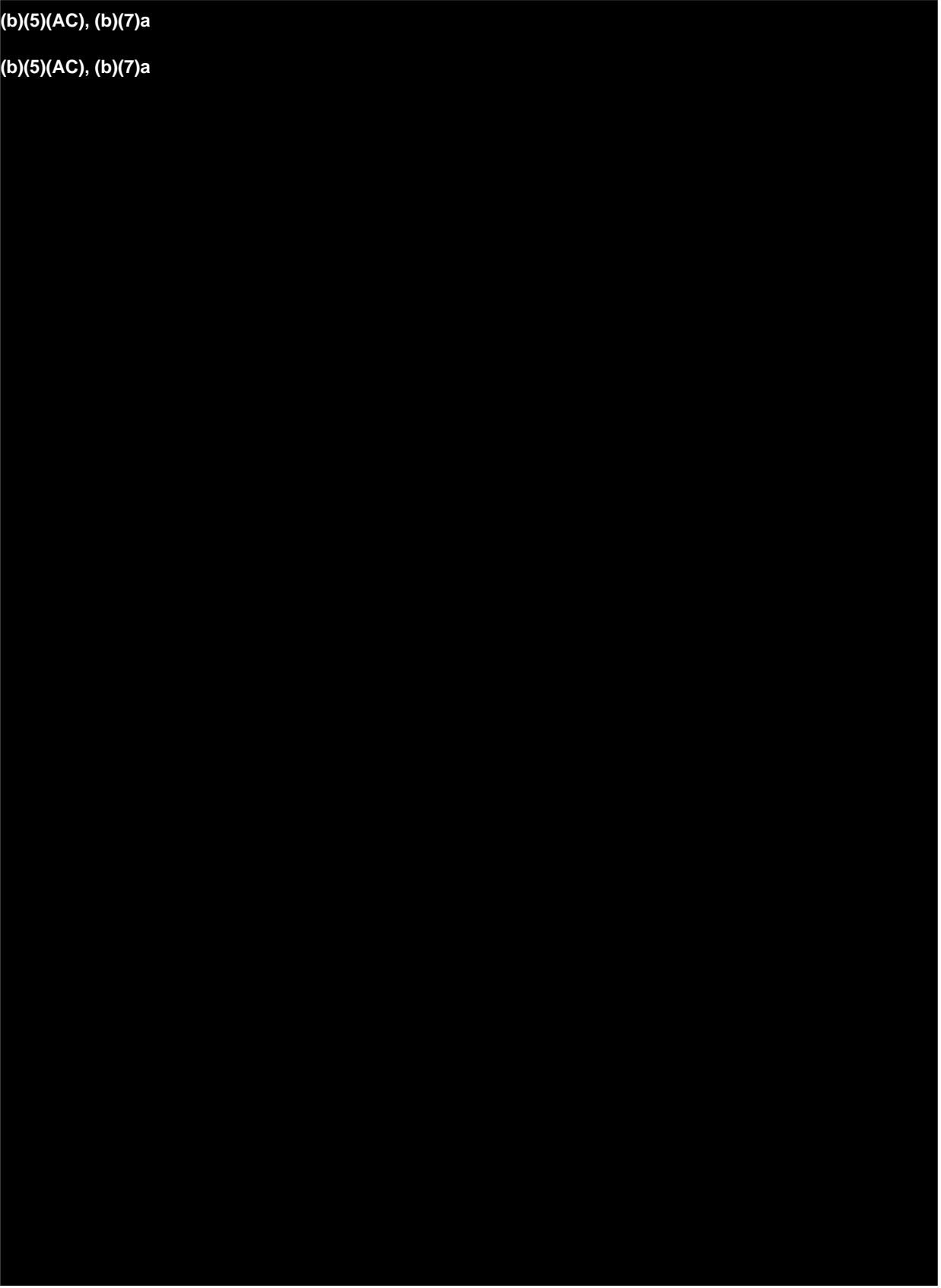


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If disclosure becomes necessary, please contact this office for our views.

This office is requesting that our National Office review our conclusion and recommendations set forth in this memorandum. Therefore, we are keeping our file open until receipt of the National Office's comments. After receipt of such comments, we will advise you of any changes to our conclusions and recommendations.

If you have any questions, please contact Ms. Lee Rountree at 404/338-7943.

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